
OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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Item Number: 330

The Waterfall

Amendments to the San Diego Municipal Code Eliminating the Surplus Undistributed Earnings ("Waterfall") Relating to the City Employees' Retirement System.

OVERVIEW

The City Council has had several previous discussions on the elimination of the "Waterfall" (see IBA Reports 07-43, 07-59 and memo 07-5), culminating most recently in direction, on June 5, 2007, to the City Attorney to develop an appropriate ordinance. To-date, this has not been done. This matter has become increasingly time sensitive however, as the SEC Independent Consultant, Stan Keller, has recommended that the City of San Diego act upon the Waterfall ordinance within 30 days of his first annual report to the SEC, presented to the City Council on April 1, 2008. For the City Council docket of April 29, 2008, the Council President docketed two ordinances for Council consideration, one ("Version A") reflecting the direction of the City Council last June and the second ("Version B") reflecting the City Attorney's original position. However, this item was continued from that hearing date as the City Attorney was working to modify Version B. A revised Version B has been submitted and this report discusses the two versions, pointing out their significant differences.

FISCAL/POLICY DISCUSSION

The IBA believes both versions accomplish the intended action to eliminate the surplus earnings concept and reform the Municipal Code. However, that is achieved in different ways by the two versions. There are two main differences: their treatment of the *Corbett* benefit and 13th check, and treatment of the Supplemental COLA.

Corbett and 13th Check

With regard to these two benefits, the main difference in the versions is that A preserves the contingency of the benefits, while B makes the benefits non-contingent, and payable each year. This is because Version B eliminates any “test” to determine if there are funds available to pay the benefit. Without a test, the benefit is always paid. In Version A, the test has been changed to eliminate any reference to surplus earnings, and instead creates an alternate test based upon the amount of investment earnings, less the amount to credit interest to member and plan sponsor contribution accounts and administration expenses. If earnings remain after this, benefits may be paid from fund assets as specified.

Supplemental COLA

Version A continues the Supplemental COLA reserve and the payment of that benefit. However, the amount in the reserve is ever-decreasing and, depending on the benefited population’s experience, it is expected that the reserve will be depleted in the future, but likely not for a number of years.

Version B discontinues the reserve but continues the benefit for a period of three years. After this time, the benefit will end and any monies previously attributed to the reserve will simply be retained as part of the trust assets. As described by the City Attorney’s Office this enables the funds previously diverted due to the “surplus earnings” concept to be returned to the trust, where it otherwise would have been had the Waterfall not existed.

The IBA wishes to point out that there are currently 954 individuals receiving the Supplemental COLA, for whom this benefit will be eliminated in three years, should Version B be approved. In addition to noting this impact on retirees, the IBA questions whether or not the Supplemental COLA is a vested benefit that, until the funding is completely depleted, could not be rescinded. The IBA requests the City Attorney to provide an opinion on this question.

Charter Section 143.1(a)

In light of the above discussion, the IBA notes that it appears that Version B would change benefits for members. In the case of the 13th check, more benefits may actually be paid out than might otherwise be the case, since the benefit is no longer contingent and would always be paid. Conversely, even if the Supplemental COLA is not a vested benefit and may be discontinued, that would appear to reduce benefits to members. Charter Section 143.1(a) requires the approval of a majority vote of the affected members when benefits are *changed*. In addition, under the same section an *increase* in benefits requires the approval of the voters. The IBA requests that the City Attorney opine as to the applicability of these Charter requirements in this situation.

CONCLUSION

Based on the above information and conversations with staff, the IBA understands that both versions would accomplish the stated intent of eliminating the Waterfall and neither would have further ramifications of which the IBA is aware, beyond those discussed here. However, we wish to ensure that Council is aware of the differences, including the elimination of the *Corbett* and 13th check contingency in Version B as well as the discontinuation of the Supplemental COLA benefit in 2011, also in Version B.

[SIGNED]

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